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ⓐ Bell Atlantic

Bell Atlantic Network Services, Inc
1133 20th Street, N.W.
Suite 810
Washington, DC 20036
202 392-1189
FAX 202 392-1369

Maureen Keenan
Director - FCC Relations

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MAY 24 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

May 24, 1994

EX PARTE

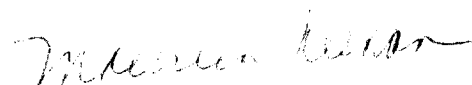
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

RE: CC Docket No. 93-179

Today, on behalf of the Ameritech, Bell Atlantic, Bell South, GTE, Lincoln, Pacific Telesis Group, Rochester, Southwestern and US West Telephone Companies, Jim Harvey (Bell Atlantic), Sherry Herauf (Pacific), and I met with Ruth Milkman, Senior Legal Advisor to Chairman Hundt, to discuss the above referenced proceeding.

Please include this letter and its attachments as part of the record of this proceeding.

Sincerely,



Attachments

cc: R. Milkman

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Add Back Overview

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Part 65 and the Price Cap Orders Contain No Provisions
Mandating Adjustment of Form 492 Interstate ROR
Results for:

- o Exclusion of Lower Formula Adjustment Revenues
- o "Add Back" of Price Cap Shared Revenues

Add Back Would Represent a Fundamental Price Cap Policy
Change and Rules Change

FCC Indicated in its Price Cap Orders that the Sharing Mechanism
was not Intended to Replicate the Commission's Earlier
Rate of Return Refund Provisions

Add Back Can Only Be Applied on a Prospective Basis

Sharing and the Lower Formula Adjustment Mechanisms Should
Be Addressed in the Broader Regulatory Policy Context of the
Price Cap Comprehensive Review

FCC Ordered Refunds vs. Price Cap Sharing

FCC Ordered Refunds

Refunds Ordered by the FCC for Violation of the ROR Prescription

Add Back of FCC Ordered Refunds in Form 492 Reporting was used as a "Report Card" to Check LECs for Violation of the Rate of Return Prescription

LECs Were Required by the Commission to Annually Retarget Rates Within the FCC Allowable Rate of Return Ceilings Based on:

Demand Forecasts

Exogenous Costs Changes

Endogenous (Operating) Costs Changes

Price Cap Sharing

Price Cap Rules Require a Prospective Pricing Adjustment to Rates if a LEC Exceeded the FCC Productivity Benchmark

No Requirement to Retarget Basket PCIs and Rates Based on Endogenous (Operating) Cost Changes

FCC Ordered Refunds vs. Price Cap Sharing

FCC Ordered Refunds

Add Back of FCC Ordered Refunds
Did Not Trigger Additional Refunds

ROR Enforcement Mechanisms include:
FCC Show Cause Action
Complaint Proceedings
FCC Tariff Filing Disallowances

FCC Refunds Ordered Were Fixed Amounts
Based on Specific Refund Liability Calculated
From a Reported ROR in the Form 492

Price Cap Sharing

Sharing Was Intended As a One – Time
Adjustment to Basket PCIs and Rates

Add Back of Sharing Triggers Additional
Sharing on Sharing

Add Back Would Extend Sharing Beyond
Being a Temporary, 12 – Month Pricing
Adjustment of PCIs and Rates

Under Price Cap Regulation, Complaints
for Excessive Earnings in Relationship
to Costs Will Not Lie With the
Commission (FCC Price Order, para. 128)

Amounts Shared Are Not Fixed Amounts
But Rather Are Based on the Relationship
of Basket APIs vs. PCIs

Illustrative Examples

Without Add Back of Sharing

	<u>Yr 1</u>	<u>Yr 2</u>	<u>Yr 3</u>	<u>Yr 4</u>	<u>Yr 5</u>
Earned Revenues	\$2,655	2,630	2,618	2,618	2,618
Expenses and Taxes	2,100	2,090	2,096	2,096	2,096
Net Income	555	540	522	522	522
Rate Base	4,300	4,300	4,300	4,300	4,300
Rate of Return	12.90%	12.56%	12.14%	12.14%	12.14%
Price Cap 50% Sharing Based on Previous Year's ROR	--	(\$25)	(\$12)	\$0	\$0

With Add Back of Sharing

	<u>Yr 1</u>	<u>Yr 2</u>	<u>Yr 3</u>	<u>Yr 4</u>	<u>Yr 5</u>
Earned Revenues	\$2,655	2,630	2,630	2,630	2,630
Add Back of Sharing	0	25	25	25	25
Adjusted Revenues with Add Back	2,655	2,655	2,655	2,655	2,655
Expenses and taxes	2,100	2,100	2,100	2,100	2,100
Net Income	555	555	555	555	555
Rate Base	4,300	4,300	4,300	4,300	4,300
Rate of Return	12.90%	12.90%	12.90%	12.90%	12.90%
Price Cap 50% Sharing Based on Previous Year's ROR including Add Back of Sharing	--	(\$25)	(\$25)	(\$25)	(\$25)

Add Back Extends Sharing Beyond Being A Single Year's One-Time Adjustment

Disincentive of Add Back

<u>Without Add Back</u>	<u>Yr 1</u>	<u>Yr 2</u>	<u>Yr 3</u>	<u>Yr 4</u>	<u>Yr 5</u>
50/50 Sharing	\$0	(\$25)	(\$12)	0	0
Cumulative Sharing	\$0	(\$25)	(\$37)	(\$37)	(\$37)
 <u>With Add Back</u>					
50/50 Sharing	\$0	(\$25)	(\$25)	(\$25)	(\$25)
Cumulative Sharing	\$0	(\$25)	(\$50)	(\$75)	(\$100)
 Add Back Disincentive	 \$0	 \$0	 (\$13)	 (\$38)	 (\$63)

Add Back of Sharing Artificially Triggers Additional Sharing
on Unearned "Hypothetical" Revenues

Add Back Undermines the Productivity Incentives Under
Price Cap Regulation and Inflates the Disincentive of a
Sharing Requirement